IN THE

Supreme Court of the United States

OCTOBER TERM, 1941

CHARLES F. CLISE and JAMES W. CLISE, JR., as Executors of the Estate of Anna H. Clise, Deceased, *Petitioners,*

vs.

COMMISSIONER OF INTERNAL REVENUE, *Respondent.*

BRIEF FOR PETITIONERS ON PETITION FOR WRIT OF CERTIORARI

I.

OPINIONS OF THE BOARD OF TAX APPEALS AND THE COURT BELOW

The opinion of the Board of Tax Appeals appears in the record (R. 29-37) and is reported at 41 B.T.A. 820.

The opinion of the Circuit Court of Appeals appears in the record (R. 62-78) and is reported at 122 F.(2d) 998.

II.

JURISDICTION

The jurisdictional statement appears in the preceding petition for writ of certiorari (*supra* pp. 6-7).

III.
STATEMENT

The essential facts are stated in the preceding petition for writ of certiorari (*supra* pp. 2-6).

IV.
SPECIFICATIONS OF ERROR

1. The Circuit Court of Appeals erred in holding that the rights of the second annuitants in the sixteen joint and survivor annuity contracts purchased by the decedent and made irrevocable at the time of purchase were not consummated gifts *inter vivos* at the time of purchase and subject to the Federal gift tax.

2. The Circuit Court of Appeals erred in holding and deciding that the rights of the second annuitants in the sixteen irrevocable joint and survivor annuity contracts purchased by the decedent were a part of the gross estate of the decedent and subject to the Federal estate tax.

3. The lower court erred in holding that the transfers to the second annuitants resulting from the decedent's purchase of the sixteen joint and survivor annuity contracts constituted in the aggregate a substitute for a testamentary disposition and that they were subject to the Federal estate tax.

4. The lower court erred in holding that the decedent reserved to herself the enjoyment of, or the economic benefit from, the contracts in question during her lifetime, and that the transfers to the second annuitants resulting therefrom were subject to the Federal estate tax.

5. The lower court erred in holding that the decision of this controversy is controlled and governed by *Helvering v. Hallock*, 309 U.S. 106.

6. The lower court erred in its application of the taxing statutes to the transfers in question by adopting a liberal policy of construction toward the estate tax and a most restrictive policy toward the gift tax.

7. The lower court erred in failing and refusing to apply the established rules of statutory construction and contract interpretation to the matters here involved and in substituting therefore the rule of practical expediency.

V.

SUMMARY OF ARGUMENT

A. The transfers in question were intended by Congress to be regarded as gifts *inter vivos* subject to the Federal gift tax and were so interpreted by the Commissioner of Internal Revenue both in the Regulations which he promulgated, and in the collecting practices which he followed.

B. Transfers by the decedent while living which were free from any retained interest or control, but in which some enlargement of the beneficiaries' rights or shifting of economic benefits coincide with the decedent's death *in point of time only* are not subject to the Federal estate tax.

C. *Inter vivos* transfers which are subject to the Federal estate tax must leave in the decedent some connecting interest or right between the decedent and the property transferred, the breaking of which by

the death of the decedent furnishes at his death the incident upon which an estate tax may attach.

D. The joint and survivor annuity contracts in question are each divisible and separate contracts, consisting of a life annuity in favor of the decedent and a deferred annuity to the second annuitant to commence at the death of the decedent.

E. *Helvering v. Hallock*, 309 U.S. 106, decides two questions as to the application of the Federal estate tax, neither of which were present in the transactions under consideration.

F. The gift tax statute and the estate tax statute are supplementary and *in pari materia*, and there is no legal justification for a policy of ultra liberality toward one statute, to the exclusion of the other, in a matter of construction between the two.

G. The test of taxability should be based upon established rules of statutory construction rather than upon shifting views as to the practical effect of transactions.

VI.
ARGUMENT

Before taking up the detailed argument, it should be noted that the Circuit Court of Appeals apparently followed the respondent's argument in the court below and found the transfers here involved to be taxable as transfers where the possession or enjoyment had been retained by the decedent, under that portion of Section 811 (c) Internal Revenue Code (*supra*, p. 7) which was written into the estate tax law by Congress as the result of the Joint Resolution of March 3, 1931. On the other hand, in the case of *Commissioner v. Wilder's Estate*, 118 F.(2d) 281, cited in the opinion of the lower court as supporting the court's position, the Fifth Circuit Court of Appeals based its decision on that portion of the statute in effect before the passage of said Joint Resolution, which taxed transfers intended to take effect in possession or enjoyment at or after death. The opinion of the court in the *Wilder* case indicated grave doubt whether the purchase of joint and survivor annuity contracts would fall within the later retention provisions of the law, but concluded that such transfers did fall within the earlier provisions which taxed transfers intended to be effective at or after death.

The evident disagreement as to the effective portion of the statute is indicative of the lack of harmony in the thought of bench and bar as to how this section of the estate tax should be applied. One writer referring to the estate tax says: "* * * At the moment (1941) the statute has reached a peak of untintelligibility." Paul's Federal Estate and Gift Taxation,

Sec. 1.08. When courts and writers cannot agree as to the meaning and application of a statute, it is next to impossible for a taxpayer to choose and follow the correct one of two doubtful courses. If the administrative interpretation of the meaning of a doubtful statute and the collection practice thereunder has been followed, then the taxpayer should be protected in his choice of procedure by the courts. We purpose to point out that under the peculiar circumstances attached to these transfers, neither the original wording of code section 811 (c) or the amendment does apply but rather that the transfers involved were intended to and do lie within the ambit of the gift tax statute.

A. The transfers in question were intended by Congress to be regarded as gifts *inter vivos* subject to the Federal gift tax and were so interpreted by the Commissioner of Internal Revenue both in the Regulations which he promulgated, and in the collecting practices which he followed.

It is admittedly a difficult task to finally determine where the transfers under discussion fit into the tax pattern as laid out by the estate and gift tax laws. The decision of this court in *Sanford's Estate v. Commissioner of Internal Revenue*, 308 U.S. 39, to the effect that the two laws "are *in pari materia* and must be construed together," is helpful but not conclusive. With reference to transfers which are free from the question of contemplation of death, it eliminates the possibility of there being an overlapping of the two statutes as to any particular set of facts by determining specifically that the two statutes are supplementary and that if one of them is applicable, the other is not.

It prevents the application of the penumbra theory to questions of construction between the estate and gift tax statutes by placing the taxing sphere of each statute in exact juxtaposition to the other, without any possible overlapping or penumbra areas between the two.

Neither taxing statute specifically refers to joint and survivor annuity contracts as being subject to tax. In the absence of any exact treatment, we are relegated to the legislative history, the administrative interpretation and the established rules of statutory construction, applied to the two statutes as one legislative enactment, to determine how such transfers should properly be taxed.

Search of the legislative history of the estate tax act, going back to its enactment in 1916, fails to reveal any instance in which congressional reports have mentioned any type of annuities by name or even suggested the taxation of such transfers. This, however, is not the situation with reference to the gift tax statute. When that legislation was being considered by Congress in 1932, the reports of both the Committee on Ways and Means of the House of Representatives and the Senate Finance Committee, discussing the pending revenue bill, referred to annuities in an inclusive way which should embrace those under consideration here. Referring to Sec. 501 of that bill, relating to the gift tax, the Committee reports indicate the broad sweep of the Congressional intent and specifically mention annuities of the general type of joint and survivor annuities. The reports are identical in this respect and read in part as follows:

"The words 'transfer * * * by gift' and 'whether

> * * * direct or indirect' are designed to cover and comprehend all transactions * * * whereby, and to the extent * * * that property, or a property right is donatively passed to or conferred upon another, regardless of the means or the devices employed for its accomplishment. For example, * * * (3) a transfer of property to B where there is imposed upon B the obligation of paying a commensurate annuity to C would be a gift to C." (Reference on p. 9 of the preceding Petition for Certiorari)

That the Commissioner of Internal Revenue and his administrative officials well understood the intent of Congress to include the transfers here under discussion as being within the scope of the gift tax statute is clearly indicated by the fact that Regulations 79, relating to the gift tax, promulgated October 30, 1933, included almost word for word the example above quoted from the Committee reports. Art. 2 (2) of Regulations 79 (1936 Edition, unchanged since promulgation) reads as follows: "(2) The transfer of property to B where there is imposed upon B the obligation of paying a commensurate annuity to C is a gift to C." Significantly this provision has been retained without change in form or wording in the Gift Tax Regulations to the present time. That wording is general, as is the taxing clause in that statute, and undoubtedly includes annuities of a commercial nature such as those in question in this case. If the intention of Congress and the interpretation of the Commissioner of Internal Revenue then acting had been to limit in any way the type of annuities taxable as gifts and to eliminate from that category annuities of a commercial type, or make any distinction with reference to

such annuities, as was suggested by the respondent in his argument to the court below, the congressional report and the regulations referred to would have been differently phrased. The use of three separate parties in the example negatives the respondent's suggestion of limitation to legacy annuities and more accurately suggests the definite intention to cover commercial annuity contracts rather than otherwise. Whether the obligation to pay the annuity was imposed by contract, deed or will, or whether the annuity was to start in the future or at once was not the intended test. The stated requirements for the transaction to be considered a gift *inter vivos* subject to the gift tax were that there be a transfer of property, that the obligation to pay the annuity be definite, and that it be commensurate with the property transferred. All of these tests are obviously met in the contracts here under discussion.

In addition to the indicated legislative intention, we find in this case not only the contemporaneous construction by the administrative officers at the time of its enactment, but a long continued construction thereafter to the same effect. As pointed out by Prof. Griswold in 54 Harvard Law Review 398, regulations established contemporaneously with the enactment of a law and long continued thereafter without change are most persuasive as to the meaning of the statute being construed. Incidentally, Professor Griswold also suggests that conflict therewith in any case should be a sufficient ground for granting certiorari. That Art. 2 (2) Regulations 79, relating to the gift tax, *supra*, treats the purchase of annuities such as are

before the court in this case as taxable gifts *inter vivos* is the opinion expressed in Paul's Federal Estate and Gift Taxation, Sec. 10.08, Note 3.

More persuasive still, as to the correctness of the petitioners' claim that the transfers involved are exclusively within the scope of the gift tax and that they were so intended by Congress and the applicable regulations, is the administrative and collecting practice of the office of the Commissioner of Internal Revenue at the time of the purchase of the contracts under discussion. Gift tax returns were accepted without protest covering these and similar purchases of joint and survivor annuity contracts. The value assigned to the contract rights of the second annuitants in each case of which the petitioners have knowledge, was the difference between the total purchase price of the joint and survivor annuity contracts and the cost of a life annuity of the same amount in favor of the first annuitant. No difficulty was encountered in securing that segregation of cost from the issuing companies. In the case of the decedent no gift tax was paid for the reason that her total gifts were within the specific gift tax exemption of $50,000.00. However, in the case of the decedent's husband, J. W. Clise, in reporting similar contracts for the gift tax which were purchased during the same period, a substantial gift tax was paid and never refunded. Incidentally. the question in this case now confronts the petitioners as executors of the estate of James W. Clise, deceased, and the matter of additional estate tax in that estate is now pending before the Board of Tax Appeals.

On the other hand the estate tax regulations, while

including several references to annuities, do so in such a way as to definitely suggest not the inclusion but the exclusion of joint and survivor annuity contracts from the taxable area of the Federal estate tax. The application of the estate tax regulations to these transfers, discussed *infra* on pages 32-34 of this brief, indicates clearly the necessity for some possibility of reverter to the decedent, or the decedent's estate, in order for the estate tax to attach. The impossibility of anything being "returned to the decedent" or becoming "a part of her estate," within the meaning of those regulations, is self-evident, on examination of the contracts in question. The changes in the regulations which were made subsequently to the decedent's death in 1936, have no bearing on this case.

The administrative and judicial attitude on this matter has been and now is in a state of flux, and the result is bewildering confusion on the part of all concerned. That condition should not be allowed to continue without legislative or judicial relief. However, when Mrs. Clise purchased these annuities, the intent of Congress, and the policy of the Commissioner of Internal Revenue, to tax them as gifts, was fixed and definite. She complied therewith fully and the respondent now contends that she was in error in so doing.

B. Transfers by the decedent while living, which were free from any retained interest or control, but in which some enlargement of the beneficiaries' rights or shifting of economic benefits coincide with the decedent's death *in point of time only*, are not subject to the Federal estate tax.

There is no dispute but that, in the case of irre-

vocable joint and survivor annuity contracts, some enlargement of the rights of the second annuitants, or some shifting of their economic benefits, occurs *as a timing event* at the death of the first annuitant. Whether this is the circumstance which convinced the Circuit Court of Appeals that the transfers involved in such contracts were substitutes for a testamentary disposition is not at all clear. Certain comments of the court would imply, however, that such was their reasoning. If that is the reason, or one of the reasons, relied upon by the lower court for this decision, it is submitted that the court is finding an entirely new incident, unsupported by legal precedent or legislative enactment, upon which to attach the estate tax, contrary to numerous decisions of this court heretofore undisturbed.

In the opinion of the lower court we find this statement: "The practical effect of the annuity contracts * * * was * * * to postpone the fruition of the economic benefits thereof to the second annuitants until her death" (R. 78). This conclusion follows closely the reasoning of the respondent in his brief before the lower court in which this statement is found: "The courts have shown an inclination to look favorably to the legislative efforts to broaden the scope of the statutes to include cases where the practical effect of the transfer is to have the time of death mark the point of a substantial enlargement of beneficiaries' rights." The argument is that every transfer is subject to the estate tax where any beneficial change as to the transfer is timed to coincide with the death of the transferor. That may not be an "unreasonable"

request if addressed to Congress, but we contend that as yet Congress has not enlarged the scope of the estate tax to that extent.

In *Reinecke v. Northern Trust Company*, 278 U.S. 339, substantially the same argument was made by the person then holding the same administrative position as the respondent, and this court rejected the claim in an opinion written by the present Chief Justice which reads in part as follows:

> "One may freely give his property to another by absolute gift without subjecting himself or his estate to a tax, but we are here asked to say that this statute means that he may not make a gift *inter vivos*, equally absolute and complete, without subjecting it to a tax if the gift takes the form of a life estate in one with remainder over to another *at or after the donor's death*. It would require plain and compelling language to justify so incongruous a result, and we think it is wanting in the present statute." (pp. 347, 348) (Italics supplied)

It is true the statement just quoted was made while construing the estate tax act as it was prior to the Joint Resolution of March 3, 1931 (H. J. Res. 529; c. 454, 46 Stat. 1516) and the subsequent amendment of Section 811 (c) of the Internal Revenue Code to give expression to the changes effected by that resolution. As has already been suggested, the question before this court may and probably does turn upon the meaning of that section before the amendment by the Joint Resolution referred to. If the statute was not then sufficiently broad in scope to include the situation claimed taxable in the *Reinecke* case, it is

not broad enough to do so now for the Joint Resolution of March 3, 1931, did not change the law in that regard. 32 Col. L. Rev. 1333 confirms the petitioners' contention that the *Reinecke* case is contrary to the proposition being discussed under this heading.

One of the most common situations presenting this question is that arising under life insurance policies taken out by the decedent under which all incidents of ownership have been irrevocably assigned to others during the life of the insured, or as to owner policies on the life of the decedent taken out and paid for by some one other than the decedent. In each of these cases there is an enlargement of the rights of the beneficiary, or a shift of economic benefits as to the beneficiary, which takes effect coincident with the death of the insured. In the latter situation no court or administrative official has even suggested that the ripening of the benefit was a taxable transfer, subject to the Federal estate tax, but if the enlargement of the rights of the beneficiary is in reality the taxable incident, then the tax should apply on the transfers just mentioned.

In the case of insurance taken out by the decedent, with all incidents of ownership irrevocably transferred by the insured to others, the decided cases and the administrative practice have long held such policies free from the estate tax. *Bingham v. U. S.*, 296 U.S. 211, *Industrial Trust Co. v. U. S.*, 296 U.S. 220, *Levy's Estate*, 65 F.(2d) 412. It should also be noted that Art. 2(5) of Regulations 79 (1936 Edition) relating to the gift tax definitely classifies such transactions as gifts. The first decision of the Court of

Claims in *Bailey v. Commissioner of Internal Revenue*, 27 F. Supp. 617, stands alone as holding that such policies might be subject to the Federal estate tax as substitutes for testamentary dispositions. The efficacy of that decision would seem to be slight in view of the subsequent history of that case and its final determination in 31 F. Supp. 778 as a possible reverter case.

Another consideration is the nature of the Federal estate tax which has been established as an estate tax and not a succession tax by a long and unbroken line of decisions of this court. The final conclusion of the court below seems decidedly inconsistent with that portion of the opinion which reads: "It (the estate tax) does not tax the interest to which the legatees and devisees succeed on death, but the interest which ceased by reason of death" (R. 69, 70). This statement seemingly admits the petitioners' contention, urged under this heading, for if the enlargement is only timed to coincide with the decedent's death, a tax thereon would clearly be a succession tax. Such a transfer lacks the vital and necessary something connecting the property and the decedent, which, when severed, makes the transfer subject to an estate tax to be measured by the value of the property transferred.

It must be admitted that certain legal writers, in discussing the confusion existing as to the application of the Federal estate tax, have recently suggested that there is no other way to account for some of the late decisions of the Board of Tax Appeals and the courts other than by recognizing an estate tax incident in any enlargement of rights timed to coincide with

the decedent's death. If that is a correct analysis, and if every transfer *inter vivos* which is enlarged in any respect or provides any shift of economic benefits on the death of the transferor, irrespective of the interest of the transferor in that transaction at his death, this court would bestow a great favor on the public at large and the legal fraternity in particular by so stating and settling the issue. This suggestion has been made in numerous discussions of the subject, including those found in Clark's Taxation of Life Insurance and Annuities 265, 49 Yale Law Journal 1118, and 29 Georgetown Law Journal 943.

Unless the principle expressed in the quotation from *Reinecke v. Northern Trust Company, supra,* is to be discarded and the original holding in the *Bailey* case sustained, the petitioners' contention here made should stand as the correct application of the estate tax. 15 Wash. L. R. 46 poses this question without attempting to answer it: If A transfers to B for A's life, remainder to C in fee, is the transfer taxable on A's death? The inquiry is identical with the question involved in this case and, under the decisions as they are, the correct answer is a negative one. Our reason is grounded upon the basic premise that the enlargement of the beneficiaries' rights must diminish the rights of the decedent in order for the tax to attach on "the interest which ceased by reason of death." As the tax is on the decedent's estate, so also must the interest which ceased be that of the decedent.

C. *Inter vivos* transfers which are subject to the Federal estate tax must leave in the decedent some connecting interest or right between the decedent and the property transferred, the breaking of which by the death of the decedent furnishes at his death the incident upon which an estate tax may attach.

When the joint and survivor annuity contract set out in the preceding Petition for Writ of Certiorari is carefully scrutinized, we believe this court will agree with the petitioners' claim as to the nature of the rights of the second annuitants under the contracts purchased by the decedent. These were irrevocable contract rights fully vested in the second annuitants when purchased and subject to divestiture only on his or her death prior to that of the first annuitant. One eminent legal writer concurs in this description of the contract as follows:

> "When the interest of the beneficiary is fixed by the terms of the contract but subject to be defeated by the happening of some event beyond the lawful control of the insured, as her death before maturity of the policy, such interest is regarded as vested, but liable to be divested." (Vance on Insurance (2d Ed.) 575)

The decedent retained no power of revocation, no power of management or disposition of, no remainder in, no possible reversion to and no control whatsoever over those contract rights in favor of the second annuitants and the purchase prices thereof. Under the well-known doctrine of *May v. Heiner*, 281 U.S. 238, these rights were fixed and determined at the time of the purchase of the contracts and were not subject to the estate tax as transfers intended to take effect

in possession or enjoyment at the death of the purchaser. See also *Shukert v. Allen*, 273 U.S. 545, *Lewellyn v. Frick*, 268 U.S. 238. As to the taxability of such transfers, Philip M. Payne, writing in 81 U. of Penn. L. R. 936, says: "The Federal tax is imposed upon the transfer of an estate upon the death of the owner (*May v. Heiner*) but it may not be imposed when in advance thereof the vested expectant estate has passed from the grantor." If *May v. Heiner* (*supra*) is no longer law, as suggested by the Board of Tax Appeals in *Estate of Mary H. Hughes v. Commissioner*, 44 B.T.A. 1196, that case should be specifically overruled by this court in order to dispel some of the confusion now existing on this subject. The same suggestion as to *May v. Heiner* is found in Paul's Federal Estate and Gift Taxation, Sec. 7.30 and 49 Yale Law Journal 1118.

The nature of the estate tax also argues in favor of our claim. It is an excise tax levied on the privilege of transmitting property at death. *Saltonstall v. Saltonstall*, 276 U.S. 260, *Ithica Trust Co. v. U. S.*, 279 U.S. 151. It is a tax on transfers from the dead to the living in which the death of the transferor is the generating event. *Tyler v. U. S.*, 281 U.S. 497. We refer again to that portion of the opinion of the lower court, quoted on page 27 of this brief. The court undoubtedly had reference to the cessation of some legal interest which actually belonged to the decedent, otherwise her death could not be the "generating event" of a tax as far as her estate is concerned. The tax is upon the estate, not the beneficiary, and is imposed only on the moving of the decedent's

interest to the beneficiary. In the case at bar the decedent had no interest in the rights of the second annuitants to collect the annuity payments now sought to be taxed, for those interests had completely vested in the second annuitants at the time the contracts were purchased. There was no connecting link of any kind, legal interest or property right, existing at the time of the decedent's death, between the right of any of the second annuitants and the decedent which ceased by reason of her death and furnished the generating event for the imposition of an estate tax. By "vested" in this connection we mean that the beneficiaries had been definitely determined and the extent of their interests irrevocably fixed by contract. A vested interest may provide for either present or future enjoyment. 67 C.J. 238.

The necessity of some such interest being firmly attached to the decedent at death was very clearly pointed out in the following quotation from the opinion in *Reinecke v. Northern Trust Company, supra,* found at page 348 thereof:

> "In the light of the general purpose of the statute and the language of Sec. 401 explicitly imposing the tax on net estates of decedents, we think it at least doubtful whether the trusts or interests in a trust intended to be reached by the phrase in Sec. 402(3) 'to take effect in possession or enjoyment at or after his death,' include any others than those passing from the possession, enjoyment, or control *of the donor at his death* and so taxable as transfers at death under Sec. 401. That doubt must be resolved in favor of the taxpayer." (Italics supplied)

Not only must the decedent's interest or string exist, but it must be potentially beneficial to the decedent. The following quotation from the *Reinecke* case states the proposition clearly: "* * * the trust, for all practical purposes, had passed as completely from any control by decedent which might inure to his benefit as if the gift had been absolute" (p. 346). Henry Rottschaefer has commented on this matter in 14 Minn. Law Rev. 632 as follows: "The mere reservation of extensive powers of control and management does not make the transfer taxable if they do not give to the donor power to control it for his own benefit (*Reinecke* case). It may therefore be taken as established since the *Reinecke* case that the effect upon taxability of the donor's reservation of powers of amendment, revocation or control depend entirely upon whether their exercise will enable him to divert to himself the economic benefit of the property." If no benefit or control to the decedent could possibly develop at any time in the future as the result of whatever connecting link there might be between the decedent and the property transferred, then the death of the decedent does not generate an incident subject to the estate tax.

Exactly the same thought is implied in the regulations promulgated by the Commissioner of Internal Revenue under the estate tax act which were in full force and effect at the time of the purchase of the annuity contracts here under consideration and also at the time of decedent's death. Reference is made to Art. 15(2) Regulations 80 (1934 Edition) describing taxable transfers during life as follows:

"Art. 15. Transfers during life.—The follow-

ing transfers made by the decedent during his life, by trust or otherwise, other than bona fide sales for an adequate and full consideration in money or money's worth, are subject to the tax: * * *

"(2) Transfers resulting from an arrangment, whether made before or after the enactment of the Revenue Act of 1916, if title was not to pass from the decedent to the beneficiary unless the latter survived the former, or title, having passed, was to be divested and the property returned to the decedent if the beneficiary predeceased him (See Art. 17); * * *"

It should be clearly noted that this Regulation requires that if the title to property had passed by transfer during the decedent's lifetime, then for such a transfer to be subject to the estate tax, the title must not only be divested, *but the property returned to the decedent if the beneficiary predeceased him.*

Reference is also made to a portion of Art. 17, Regulations 80 (1934 Ed.) as follows:

"Art. 17. Transfers conditioned on survivorship—The expression, 'a transfer * * * intended to take effect in possession or enjoyment at or after his death,' includes a transfer resulting from the execution of a written instrument or the making of an oral arrangement, without an adequate and full consideration in money or money's worth, whereby title was not to pass from the decedent to the beneficiary (or, if title passed it was to be defeated) unless he survived the decedent, and should he not so survive, the property is to be restored to the decedent or become a part of his estate. * * *"

In the above regulation it is provided that when the

title to property passed by transfer from the dec dent during his lifetime, in order for an estate ta to result at his death, it must be found that the *pro erty is to be restored to the decedent or become a pa of his estate* in the event that the donee did not su vive the decedent.

This is also the holding of the Circuit Court of Ap peals for the Third Circuit in *Commissioner v. Kellogg* 119 F. (2d) 54, the opinion in that case reading i part as follows:

> "It would be bootless to reiterate in this opin ion the circumstances of the cases discussed i *Helvering v. Hallock.* It is sufficient to state tha in all the cases referred to in the majority opin ion of the court, as well as in the opinion of Jus tice Roberts, a string or tie was inserted in th trust indenture *whereby the grantor might pul back the corpus to himself* upon the happenin of some contingency terminable only by hi death." (Italics ours)

In the *Kellogg* case the trust involved "did not pro vide any string or tie in the instrument whereby h (the decedent) could pull the res back to him or in vade the corpus" and the court held that it was no subject to the estate tax. Likewise in the transfers here being considered there was no string betwee the decedent and the property transferred nor could the decedent or her estate ever possibly benefit from such property.

D. The joint and survivor annuity contracts in question are each divisible and separate contracts, consisting of a life annuity in favor of the decedent and a deferred annuity to the second annuitant to commence at the death of the decedent.

The lower court has erroneously assumed that the contracts purchased by the decedent are indivisible and that the decedent in each case retained the economic benefits from the dual contracts for her lifetime. In arriving at this conclusion the court has ignored the various factors ordinarily examined as legal determinants of the problem presented and has decided the question "practically" in a way contrary to the petitioners' contention. We contend that the contracts for tax purposes and for all other purposes are each divisible into the decedent's life annuity and the life annuity in favor of each respective second annuitant.

Whether two contracts joined in the same document are indivisible or separate contracts is to be determined by the intention of the parties and the circumstances surrounding the contracts, not by the fact that they are written on one or more pieces of paper. 13 C.J. 562. By striking out the word "jointly" in the covenant to pay, the parties to the contract set forth in the preceding Petition for Writ of Certiorari (p. 3) completely negatived any suggestion that the two annuities therein provided for constituted an indivisible contract on the part of the insurance company.

An agreement to do several things at several times is a divisible contract. 13 C.J. 561. In every contract

here under discussion, the obligation of the insurance company is to make two series of payments, first to the decedent during her lifetime and thereafter to the respective annuitants. The obligations follow in point of time and are not concurrent.

An agreement involving similar obligations to more than one person which can be enforced at law in separate actions by each of such persons is not an indivisible contract. The second annuitants in these contracts had no right of action while the decedent lived. In 12 Am. Jur. 816 the rule is stated as follows: "When persons are severally entitled to the performance of a contract, they are separately entitled, and they may and must enforce their rights separately in the absence of a statute providing otherwise."

One test generally used to determine whether a contract is divisible is the possibility of apportionment of the consideration. From the opinion of the lower court it is entirely feasible to show that the considerations for these contracts can be accurately apportioned between the decedent's life annuities and the annuities in favor of the second annuitants. In that opinion (R. 63) we find that on December 28, 1934, the New York Life Insurance Company issued to the decedent a straight life annuity contract providing for monthly payments to her during her life of $41.00 per month for which she paid a cash consideration of $5,189.80 (see also R. 54). Obtaining the annuity contracts was not dependent on any conditions such as the issuance of contemporaneous insurance policies. A simple arithmetical calculation (division) shows that the consideration for each $1.00 of monthly an-

nuity income was $126.58. On November 23, 1934, the same day that the decedent applied for the straight life annuity just mentioned, she also applied to the New York Life Insurance Company for four of the joint and survivor annuity contracts here under consideration. One of these four contracts was No. 55829 which provided for payment to the decedent for her life of $31.28 per month and a like sum to her son, James W. Clise, Jr., during his lifetime, if he survived her (R. 54). Simple multipication (31.28 x $126.58) shows that decedent paid $3,959.42 for her straight life annuity and the balance of the total consideration, $3,540.58, for the annuity contract in favor of her son, James W. Clise, Jr. There is no inaccuracy in this apportionment even though the two contracts were dated eighteen days apart, for, as the contracts in evidence before the Board show, the monthly payments in each contract commenced on December 23, 1934, just thirty days after the payment of the consideration. The important thing to know is that the consideration could be and was apportioned as the petitioners have contended throughout this controversy. As the contracts are all similar, a like apportionment of the consideration for each of the other contracts is possible.

To completely explain our contention let us look at the separate contracts microscopically. Decedent's life annuities called for monthly payments to her for her life and for each such contract, as we have just shown, she paid a readily calculable portion of a larger consideration. There is no mystery as to how insurance companies calculate the cost of straight life an-

nuities. It is a matter of elementary mathematics and accounting with which all are familiar. On receipt of an application for a life annuity by an annuitant of a certain age, the applicant's life expectancy is ascertained from the mortality tables then in use. Having determined that factor, the amount of money necessary to make the annuity payments for the expected number of years is determined. Knowing the necessary "loading" charges for expenses, the rate of income return being received on its investments, and the number of payments to be anticipated, the calculation of the amount of money which will at interest be needed to meet all of the obligations of the contract as they mature is a simple matter of actuarial computation. That is the consideration which is charged for that annuity. The calculation of the amount of the payments to the annuitant necessarily includes a consideration of the earning power of the purchase price and is correspondingly higher by reason of such estimated earnings.

The annuity payments to the second annuitants were the same in amount as to the decedent; for annuity purposes they were to begin at a date certain in the future, at the end of the life expectancy of the decedent; they were to continue for the lives of the second annuitants and were to terminate with the last monthy payment prior to his or her death. The consideration paid by the decedent for each of these contracts in favor of the respective second annuitants was the amount paid for such dual contract in excess of the cost of the life annuity for the decedent concurrently issued therewith ($3,540.58 in the case of the New

York Life Contract No. 55829). The amount of these considerations for the second annuities must of necessity depend on the age of the second annuitants and their life expectancies and varies as the age of the second annuitants differ. Based on these ages, the payments are expected to terminate on fixed dates. All of the estimated income on the considerations paid for these second annuities inheres in the amount which the company agreed to pay to the second annuitants and increases the amount of the annuity payments. *That income does not find its way back to the decedent under any reservation but is entirely consumed in providing for the larger annuities for the second annuitants.* Whatever the decedent received under these dual contracts during her lifetime was paid to her as the direct obligation of the insurance companies under her life annuity contracts and *not as any retention of interest in the contracts in favor of the second annuitants.*

As a part of the opinion of the lower court we find this statement: "Unquestionably, Mrs. Clise, the first annuitant, reserved for herself the enjoyment—the economic benefit, of these contracts during her lifetime. This is true, just as surely as though she had created a trust fund with her property—money, and reserved to herself a certain sum annually, to be paid out of income and corpus, with the remainder over" (R. 74, 75). This suggests three conclusions reached by the court: (1) The contracts in question were indivisible contracts; (2) these transfers were analogous to trusts with the income and a part of the corpus in each case reserved to the decedent; (3)

there was a trust fund and a remainder over to each of the second annuitants.

We have already pointed out the differentiating factors between indivisible and separate contracts, all of which the court has ignored in reaching its first conclusion. Equally erroneous are the second and third conclusions for the analogy to a trust must fail. The situations are entirely different. In a trust there would have remained upon the death of Mrs. Clise a trust *res*, a remainder of the trust fund, which of necessity would have reverted to the transferor or have been transferred to some beneficiary to provide the necessary estate tax incident. Such, however, is not the case, for if any of the second annuitants had predeceased Mrs. Clise there would have been no other possible beneficiary and no possible reverter or remainder to her or her estate as to any trust fund. This shows that the transfers here involved all took place prior to the death of Mrs. Clise. The company in each instance merely occupied the position of any ordinary debtor to two unsecured creditors for separate and distinct debts. When Mrs. Clise died only contract rights continued which had been irrevocably fixed and determined at the time of purchase and in which she had retained no interest of any kind, and from which neither she nor her estate could derive any benefit. No transfer occurred at her death, hence no estate tax obligation can possibly attach to her estate.

Further difficulties present themselves when we examine the possibilities of the court's determination that the decedent "retained the economic benefits of the contract." The court below referred in a marginal

note to Sec. 22(b)(2) of the Revenue Act of 1934 c. 277, 48 Stat. 680 (R. 67), relating to income taxes, as one of "the statutes necessary to intelligent consideration of the problems involved." We assume that the court, following the respondent's argument, deemed the payments which decedent received were made up of 3% of the cost of the joint annuities as income retained and the balance a return of corpus. That suggestion runs afoul of the well-understood principle established in *Towne v. Eisner*, 242 Fed. 702, 704, quoted with approval in *Eisner v. Macomber*, 252 U.S. 189, 202, that Congress cannot transform into income that which is not income by a mere declaration. Sec. 22(b)(2) of the income tax law may properly impose an income tax on a certain portion of the return of an annuity contract (3% of the cost) but that determination can have no bearing outside of its own particular statute, especially when in conflict with the usual and ordinary definition of the term "income."

In the event that the two annuitants in any of the contracts purchased by the decedent should outlive their life expectancies, the annuity payments will have exhausted the consideration paid and the earnings thereon, and thereafter the payments will have to be made by the insurance company from its general funds contributed by other annuity and insurance purchasers. If the analogy to a trust, with income and corpus payments reserved, were correct, the payments would stop when the trust fund was exhausted. Such is not the case, showing that the court's assumption is erroneous. The continued payments for the combined period of the two annuities are payments in accordance

with definite contract rights and not under any trust with the income reserved.

Again the error of the lower court's reasoning appears from a consideration of the matter of the valuation of the rights of the second annuitants. If these transactions created trust funds, with income and corpus payments reserved, as claimed by the respondent, then the valuation at any date should be the difference between the purchase price and the total of the corpus payments theretofore returned to one or both of the annuitants. But that is not the position of the respondent and that valuation is not acceptable to him. For valuation purposes he claims under the authority of *Guggenheim v. Rasquin*, 312 U.S. 254, the transactions are contracts for definite money payments and must be valued at the commercial cost of similar contracts on the date of the decedent's death. These valuations may, on account of reduced interest rates, exceed the total considerations paid by the decedent for the dual contracts, an impossibility if the respondent's trust fund argument is correct. That argument is clearly fallacious for the transfers in question are vested contract rights for certain definite annuity payments and they cannot at the same time be trust funds with interest reserved in the decedent. The applicable tax was the gift tax with which the decedent fully complied.

E. *Helvering v. Hallock*, 309 U. S. 106, decides two questions as to the application of the Federal estate tax, neither of which are present in the transactions under consideration.

The two matters settled by *Helvering v. Hallock, supra*, are: (1) in applying the estate tax, that decision wipes out the distinction between vested and contingent remainders and (2) that decision holds that the determination of the possibility of a remote reverter to the decedent provides the necessary incident for the imposition of the Federal estate tax. In doing so it affirms *Klein v. U. S.*, 283 U.S. 231, and overrules *Helvering v. St. Louis Union Trust Co.*, 296 U.S. 39, *Becker v. St. Louis Union Trust Co.*, 296 U.S. 48. We have no quarrel with the *Hallock* case, but care must be taken to apply its doctrine only to cases arising under the same or similar facts.

The dicta found in the *Hallock* case has provided material for extensive discussion by legal writers and its meaning has proven extremely troublesome, both to courts and attorneys. The following are indicative of the confusion existing; Paul's Federal Estate and Gift Taxation Sec. 7.23, Clark's Taxation of Life Insurance and Annuities 171; 18 Taxes 267, 324; 29 Georgetown Law Journal 943; 49 Yale Law Journal 1118; 34 Ill. Law Rev. 867; 18 Texas Law Rev. 470; 40 Columbia Law Rev. 773. The difficulty in deciding whether certain factual situations fall within the scope of the estate tax or the gift tax seems to have been intensified since the *Hallock* case was handed down. The result has been that officials in charge of the administration of the estate tax have been greatly

encouraged to resolve borderline cases in favor of the estate tax. We are inclined to agree with the conclusion of the Circuit Court of Appeals for the Third Circuit, in *Commissioner v. Kellogg, supra,* when that court said: "No *inter vivos* trust can ever be made that would not be includable in the grantor's estate for the purpose of taxation if the petitioner's (Commissioner of Internal Revenue) view prevails." It is unthinkable that such is the present status of the law. What are "*inter vivos* transfers that are too much akin to testamentary dispositions not to be subject to the same excise" (R. 77) within the meaning of the *Hallock* case is still a profound mystery. If this court, in deciding that case, intended to overrule *May v. Heiner, supra, Shukert v. Allen, supra, Nichols v. Coolidge,* 274 U.S. 531, and *Reinecke v. Northern Trust Company, supra,* as has been suggested in 29 Georgetown Law Journal 943, we feel that this change of concept as to what is a taxable transfer should be accomplished in a more specific manner than has been done as yet. Until something more definite is done in respect thereof by Congress or by this court, the petitioners believe the cases referred to are still controlling and should be followed. The matter is an important one from every standpoint and should not remain clouded with the uncertainty which now exists.

The court's opinion also cites *Commissioner v. Estate of A. M. Wilder,* 118 F.(2d) 281, certiorari denied Oct. 13, 1941, as authority for its decision. The facts in that case however are essentially and fundamentally different from those in the case at bar. In

that case the joint and survivor annuity contracts (husband first annuitant, wife second annuitant) were purchased with community funds. The contract purchased with community funds, became community property *in toto* at the time of purchase and so continued until the death of the husband. No claim that the transfers were gifts was made and there was no showing of an attempt to comply with the gift tax statute. The Louisiana law, Section 1749 of the Civil Code, as pointed out by the United States District Court for the Eastern District of Louisiana in *Howard v. United States*, 40 F. Supp. 697, regards all transfers of property between husband and wife as revocable by the donor and not as consummated gifts. On the death of either spouse that right of revocation terminates. Revocable transfers have always been held subject to the federal estate tax and we are not claiming otherwise. The case is not in point in this controversy.

F. The gift tax statute and the estate tax statute are supplementary and *in pari materia*, and there is no legal justification for a policy of ultra liberality toward one statute, to the exclusion of the other, in a matter of construction between the two.

Sanford's Estate v. Commissioner, *supra*, is authority for the petitioners' claim that the lower court committed error in its liberality of construction in applying the provisions of the estate tax law to the facts in this case. This matter has been referred to in the arguments already advanced but needs some further comment. The time honored policy of the courts toward the taxpayer in controversies with the taxing power has been that, on account of his vulnerable

position as compared with that of the tax collector, he is entitled to the benefit of any and all doubts that may arise as to the meaning and scope of the taxing act. *Gould v. Gould*, 245 U.S. 151; *U. S. v. Merriam*, 263 U.S. 179. There is nothing to indicate that Congress ever intended the estate tax act to embrace contracts such as the joint and survivor annuity contracts here under discussion. In the light of the legislative history of the gift tax act already discussed, if there was any doubt, that doubt should be resolved in favor of this taxpayer.

Most of the cases which have decided that certain borderline transfers were subject to the estate tax act were handed down prior to the enactment of the gift tax law. With the end in view of preventing tax avoidance, a policy of liberal construction was often adopted to extend the taxing area into a penumbra field outside of the precise wording of the statute itself. One writer suggests that to prevent tax avoidance this court has "painfully developed an inclusion of interest and a concept of transfer which is unique." 38 Mich. Law Rev. 1032. Those circumstances probably justified a liberal policy of construction, but with the enactment of the gift tax act in 1932 the conditions changed. The adoption of that tax statute was avowedly for the purpose of preventing estate tax avoidance and of bringing into the taxable area those penumbra situations which were questionable before. Since the decision of this court in the *Sanford* case established that the two taxing acts are supplementary, it is clear that one policy of construction must govern in the application of both statutes for they

are part and parcel of the same legislative enactment. Petitioners submit that the policy to be used in construing the estate and gift tax statutes and their application to a given set of facts should be to place them on an equal footing without preference to either. Only in that way can the prevalent doubt as to whether a transaction falls within the scope of one or the other be satisfactorily eliminated.

The petitioners believe that the lower court, consciously or unconsciously, construed the estate tax statute in a most liberal manner to prevent what that court believed might have been an effort to avoid taxation. The following portion of the court's opinion plainly indicates such to have been the case: "Though Mrs. Clise was a woman of considerable wealth the estate tax return filed in behalf of her estate disclosed no tax liability." A court of law has no right to extend the ambit of the estate tax law into the exemption area established by the gift tax law under the guise of preventing tax avoidance. Between two courses of procedure, one involving a present gift tax liability and the other a possible estate tax liability on her death, the decedent had the right to choose the one involving the gift tax. *Gregory v. Helvering*, 293 U.S. 465, *Superior Oil Co. v. Miss.*, 280 U.S. 390. In fact, a taxpayer can still give away all of his property, and if the value of his donations lie within the gift tax exemptions, and if the gifts were not made in contemplation of death, both of which were found to exist in this case, no estate tax should apply. The consummated gift *inter vivos* of all the property of a taxpayer does not at the time of his death generate

an estate tax incident, as the law stands at the present time.

G. The test of taxability should be based upon established rules of statutory construction rather than upon shifting views as to the practical effect of transactions.

If the test of practicability is to determine whether the estate tax or the gift tax is to apply to the transfers here involved, then the practical effect from the taxpayer's standpoint should be examined with the same or greater care than that used in considering the claims of the tax collector. We deplore the tendency of law courts to decide law questions on the basis of the "practical effect" of the situations being examined. The meaning of this approach is that the "legal" effect, with all of its protective influence, has been abandoned and something allegedly better has been substituted therefor. In this particular case, the decision of the Board of Tax Appeals in favor of the petitioners has been set aside and the lower court has disagreed with the reasoning found in *Chemical Bank & Trust Co. v. Commissioner*, 37 B.T.A. 535, for indefinite reasons based upon arguments most laboriously constructed. The danger is that when the charted "legal" course has been abandoned and the practical substituted therefor, then we have a government of men rather than a government of law and navigation difficulties, in a legal sense, develop immediately.

In the instant case, in order to reach its decision on the "practical effect" basis, the established rules of

contract interpretation discussed on pages 35-36 of this brief were all ignored; also the rules as to the relative position of the taxpayer and the tax gatherer in tax controversies (page 46 of this brief). Such arguments as have been advanced by the respondent and the lower court might possibly be made before a legislative body, but are certainly out of place when presented to and by a court of law. The question here for consideration is one of interpreting statutes passed by Congress and not in determining whether Congress has a certain taxing power. We do not here question the right of Congress to tax the contracts under discussion, but we vigorously deny that as yet that power has been exercised.

The opinion of the lower court suggested the analogy of the trust fund with rights reserved to the decedent. This analogy, as has already been pointed out, will not stand the valuation test, or the possibility of the prior death of the second annuitants or the possibility of both annuitants outliving their life expectancies. The comparative valuations show the inconsistency of the trust fund argument. In the second case, the contract rights would have died with the second annuitants and no trust fund would have remained for any beneficiary. In the third case, subsequent payments would continue after the trust fund was exhausted, in accordance with the original contract rights and contrary to the trust fund theory. Those contract rights came into being when the contracts were purchased and will continue until the death of the several annuitants without change except as to their value. That value would have been

zero if any of the second annuitants had predeceased the decedent. The value of those rights may fluctuate but the rights themselves do not change in any particular. We submit again that Congress never intended to impress an estate tax on the mere increase in value of *inter vivos* transfers which were entirely devoid of property rights or powers of some kind moving from the dead to the living.

The lower court in effect holds these transfers to be a substitute for a testamentary disposition. Congress undoubtedly intended to make testamentary disposition subject to the Federal estate tax, *i.e.*, dispositions which are ambulatory, subject to change or control at the testator's wish and which operate prospectively. Atkinson on Wills 151; Page on Wills (2d Ed.) 120, Sec. 70; 28 R. C. L. 62, Sec. 6. But these transfers are not ambulatory, or subject to the testator's control or wish, nor is there any possible reverter to the decedent, nor any of the other factors which have been held taxable under the prior rulings of this and other courts, and they were not made in contemplation of death. They are totally lacking in any of the attributes of testamentary dispositions.

The practical effect should be examined from all sides before being accepted as the rationale of this case. It is enlightening to examine the practical effect of these transactions from the purchaser's standpoint, at the same time recognizing the rule of contract and statutory construction previously discussed. Decedent in each case purchased a life annuity on her own life providing for certain payments as long as she lived and for an additional consideration ($3,540.58

in the case of New York Life Insurance Co., No. 55829 previously mentioned), she purchased a like annuity on the life of the second annuitant named in each contract. These were two separate and distinct contracts though written into one instrument. Whatever the decedent received under the dual contracts was paid to her as the direct obligations of the insurance company under her life annuity contracts and not as any retention of interest in the separate contracts in favor of the second annuitants. There was no enlargement of the rights of any of the second annuitants on the decedent's death, that event merely serving as the date from which payments should thereafter be made to the second annuitants in accordance with contract rights definitely fixed and vested when purchased. How can it be said that practically the decedent reserved the enjoyment of the contracts (rights of the second annuitants) when she already was entitled to all of those benefits under her own life annuities purchased with the smaller considerations? If she had retained any valuable interest in the contracts in favor of the second annuitants, as claimed by the lower court, such retention must have potentially enlarged her rights in some way. That was impossible under the contracts as drawn.

Unless and until Congress defines the term "substitute for a testamentary disposition" as including any transfer which coincides with the death of the decedent *as a timing event only*, where there is no retention of interest or control in the decedent at death, the petitioners submit that transfers such as those here in

question are free from liability for the Federal estate tax.

CONCLUSION

For these reasons we respectively submit that the decision of the Board of Tax Appeals is correct and that of the Circuit Court of Appeals is erroneous and should be reversed upon an allowance of the Writ of Certiorari petitioned for herein.

Respectfully submitted,

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